

**ST 98-7**

**Tax Type: SALES TAX**

**Issue: Books And Records Insufficient**

**STATE OF ILLINOIS  
DEPARTMENT OF REVENUE  
OFFICE OF ADMINISTRATIVE HEARINGS  
CHICAGO, ILLINOIS**

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<b>THE DEPARTMENT OF REVENUE</b>	)	Docket No.
<b>OF THE STATE OF ILLINOIS</b>	)	IBT No.
v.	)	NTL Nos.
<b>TAXPAYER</b>	)	
	)	John E. White,
Taxpayer.	)	Administrative Law Judge

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**RECOMMENDATION FOR DISPOSITION**

**Appearances:** Edward Williams appeared for TAXPAYER Gary Stutland appeared for the Illinois Department of Revenue.

**Synopsis:**

This matter arose when TAXPAYER ("TAXPAYER" or "taxpayer") protested two Notices of Tax Liability ("NTL") issued by the Illinois Department of Revenue ("Department"). Notice of Tax Liability ("NTL") number XXXXX assessed Retailers' Occupation tax regarding the period beginning 1/1/92 through and including 11/30/93, and NTL number XXXXX assessed tax regarding the period from 12/1/93 through and including 12/31/95.

During a pre-hearing conference counsel for each party identified the issue to be resolved at hearing. Counsel for the Department characterized the issue as whether TAXPAYER underreported its [taxable] gross receipts, and counsel for TAXPAYER phrased the issue as whether it should be given credit for bank deposits of lottery receipts. I have reviewed the evidence adduced at hearing, and I am including in this recommendation findings of fact and conclusions of law.

**Findings of Fact:**

**Facts Regarding TAXPAYER's Business:**

1. TAXPAYER Food and Liquor is a corporation engaged in the business of making retail sales of tangible personal property, to wit: grocery items, food and liquor, at VICTITOUS CITY, Illinois. Department Group Ex. No. 1, pp. 2-3; Hearing Transcript (hereinafter "Tr."), p. 12 (testimony of Department auditor Patricia Johnson ("Johnson")), pp. 108-09 (testimony of WITNESS ("WITNESS")).
2. WITNESS is the President of taxpayer, as well as one of its three employees. Tr. pp. 108-09 (WITNESS).
3. During the audit periods, taxpayer did not keep and maintain the types of books and records required to be maintained by the Retailers' Occupation Tax Act ("ROTA"), 35 ILCS 120/7, or by regulations promulgated by the Department under its authority thereto. Tr. p. 110 (WITNESS); *see also* 86 Ill. Admin. Code §§ 130.801 (General [Recordkeeping] Requirements), .805 (What Records Constitute Minimum Requirement), .810 (Records Required to Support Deductions) (1988).
4. Taxpayer sold lottery tickets at its business. *See* Taxpayer Ex. No 1 (Stipulation of Department and TAXPAYER). The net receipts TAXPAYER realized from lottery sales amounted to approximately two hundred thousand dollars during each of the years in the audit period. *Id.* Throughout the audit period, the Illinois Department of Lottery regularly (i.e., weekly) withdrew amounts from TAXPAYER's bank account electronically. Tr. pp. 89-90 (Johnson).
5. WITNESS deposited some, but not all, of the cash TAXPAYER realized from its

business into TAXPAYER's bank account at National Bank. Department Ex. No. 1, pp. 2-3 (on the top of the Department's corrections of TAXPAYER's returns, it notified taxpayer that the determination and calculation of monthly taxable receipts was made via a review of TAXPAYER's bank deposits); Tr. pp. 113-14, 116 (WITNESS). WITNESS also deposited the food stamps it received during the course of its business into TAXPAYER's bank account. Department Ex. No. 2, pp. 12-13 (auditor's schedule of TAXPAYER's bank deposits, including the amounts of food stamps the bank identified as having been deposited by TAXPAYER during each of the 48 months in the audit period); Tr. pp. 113-14, 116 (WITNESS).

6. WITNESS testified that he made, but did not retain, journals in which he recorded the amounts of gross receipts TAXPAYER realized each day. Tr. pp. 111-12 (WITNESS). He then informed TAXPAYER's accountant of the gross sales the business realized based on the information he allegedly recorded. *Id.* p. 112.

**Facts Regarding the Department's Audit:**

7. Notwithstanding taxpayer's failure to maintain all the required books and records, the Department's auditor was provided with, either by taxpayer or through her own efforts, the following books and records regarding taxpayer's business during the audit period:
  - taxpayer's ST-1 returns (i.e., monthly ROT returns) filed with the Department, Tr. p. 12 (Johnson).
  - copies of taxpayer's federal income tax returns, Tr. p. 13 (Johnson).
  - records regarding taxpayer's purchases of newspapers and magazines, Department Group Ex. No. 2, p. 8.

- records regarding taxpayer's purchases of merchandise from some, but apparently not all, of its suppliers. Department Group Ex. No. 2, p. 11.
  - copies of taxpayer's complete bank statements and records for the 48 months of the audit period, which statements and records included: information regarding taxpayer's food stamp deposits; information regarding checks drawn on taxpayer's account; checks deposited in taxpayer's account and returned due to insufficient funds; and the frequency and amounts of automatic electronic withdrawals from taxpayer's account by the Illinois Department of Lottery. Department Group Ex. No. 2, pp. 12-13; Tr. pp. 89-90 (Johnson).
  - a letter from the United States Department of Agriculture ("USDA") regarding the amounts of food stamps the agency received for 41 of the 48 months in the audit period, following TAXPAYER's deposits of food stamps into its bank for the same periods. Department Group Ex. No. 2, pp. 5-7.
8. The Department's correction of TAXPAYER's returns was based, in part, on the auditor's determination that TAXPAYER underreported its gross receipts. The auditor determined that TAXPAYER's gross receipts were not accurately set forth on line 1 of its returns, and that the better estimate of TAXPAYER's gross receipts was reflected by the amounts of TAXPAYER's bank deposits. Department Group Ex. 1, pp. 2-3.
9. Additionally, the Department's correction of returns was premised on the auditor's decision to disallow certain deductions TAXPAYER claimed on its returns. Specifically, deductions were disallowed for the amounts of tax TAXPAYER reported as having charged and collected from its customers (*see* Department Group Ex. No. 2, pp. 1-2), and for food stamps received during the last seven months of the audit period (*id.* pp. 6-7).

### **Conclusions of Law:**

At the beginning of the hearing, and shortly after the ALJ identified for the record

the issues as articulated by counsel during the pre-hearing conference, counsel for the Department stated:

Judge, I noticed in the pretrial order you mentioned underreported receipts[.] [T]here is an issue of a certain of a certain deduction that was disallowed, and there will be testimony with regard to a claim deduction.

Tr. p. 4. The issue statements recorded in the pre-hearing order, however, were not merely “mentioned” by the ALJ. What was documented within that order was each counsel’s characterization of the issue(s) to be resolved at hearing, as provided for by the Department’s hearing rules (*see* 86 Ill. Admin. Code § 200.140(b)). Both attorneys read that order before the ALJ signed it, and each attorney received a copy of that order at the conclusion of the conference.

When asked to respond to counsel’s argument that “a claim deduction ... was always an issue” (*see* Tr. pp. 4-5 (emphasis added)), counsel for TAXPAYER made no objection. *Id.* Nor was any objection made when the Department subsequently offered evidence regarding the *two* types of deductions the auditor disallowed. More likely than not, counsel was not surprised by the Department’s identification of those issues at hearing because taxpayer had, during audit, been notified that certain deductions would be disallowed. *See* Department Group Ex. No. 2, p. 10 (summary analysis of tax due). In any event, since taxpayer waived any legitimate objection it may have had, I will address the issue of underreported receipts, as well as the issues of the different deductions disallowed.

The Department introduced its corrections of TAXPAYER’s returns into evidence under the certificate of the Director. Department Group Ex. No. 1, pp. 1-3. The Department’s correction of a taxpayer’s returns constitutes *prima facie* proof of the correctness of the amount of tax due. 35 ILCS 120/4. The Department’s *prima facie* case is a rebuttable presumption. Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157, 242 N.E.2d 205, 207 (1968); DuPage Liquor Store, Inc. v. McKibbin, 383 Ill. 276, 279,

48 N.E.2d 926, 927 (1943). A taxpayer cannot overcome the presumption merely by denying the accuracy of the Department's proposed assessment. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833 (1st Dist. 1988). Instead, a taxpayer must present evidence which is consistent, probable and identified with its books and records to show that the proposed assessment is not correct. Filichio v. Department of Revenue, 15 Ill. 2d 327, 333 (1958); A.R. Barnes & Co., 173 Ill. App. 3d at 833-34.

TAXPAYER rebutted the *prima facie* correctness of the Department's determination regarding TAXPAYER's taxable gross receipts. The Department argued that the best evidence of TAXPAYER's taxable gross receipts was reflected by the full amount of its bank deposits, because TAXPAYER had no records by which its wholesale purchases could be ascertained. Contrary to the Department's argument, however, this issue is not one involving the unavailability of books and records. Here, the auditor had an opportunity to obtain, review and compare vendors records regarding TAXPAYER's wholesale purchases with TAXPAYER's federal income tax returns (which identified TAXPAYER's cost price of goods sold), and with the amounts of gross receipts TAXPAYER reported on TAXPAYER's Illinois ROT returns. *See* Department Group Ex. No. 2, p. 11. This is not a case in which the Department's determination that the taxpayer underreported taxable gross receipts is supported by evidence that the taxpayer's wholesale purchases exceeded its reported receipts.

The auditor's preference for TAXPAYER's bank deposits as the better indicator of taxable gross receipts than the amounts reported on TAXPAYER's returns ignored both the information contained in taxpayer's bank statements, and the patent reasonableness of taxpayer's explanation of why the former exceeded the latter. TAXPAYER's total bank deposits exceeded its reported taxable gross receipts because taxpayer deposited into that account some of its receipts from lottery sales, as well as the receipts from making taxable sales at retail. Tr. pp. 115-16 (WITNESS). WITNESS's testimony in that regard is both reasonable and closely identified with the books and

records made available to the Department's auditor. *See* Tr. pp. 89-90 (Johnson stated that taxpayer's bank statements showed weekly electronic withdrawals by the Illinois Department of Lottery).

While WITNESS admitted that his business failed to maintain the books and records required to be kept, his testimony regarding TAXPAYER's practice of depositing cash receipts from both lottery sales and sales of goods was closely identified with the frequency and amount of deposits detailed in TAXPAYER's bank statements. Those records were made available for the Department's inspection and audit, and a schedule of TAXPAYER's bank deposits was introduced at hearing. *See* Department Group Ex. No. 2, pp. 12-13. That the deposit slips included in TAXPAYER's bank records did not identify the sources of the monies deposited (i.e., the deposit slips did not indicate that, e.g., on 2/1/94, \$100.00 in cash from sales of goods and \$100.00 cash from lottery sales were deposited into the bank account) does not render WITNESS's testimony that he deposited lottery receipts less credible. To the contrary, it seems patently unreasonable to believe that taxpayer deposited no lottery receipts into an account from which -- the auditor conceded -- the Illinois Department of Lottery electronically withdrew thousands of dollars each week. Tr. pp. 89-90 (Johnson).

After TAXPAYER rebutted the *prima facie* correctness of the Department's determinations that TAXPAYER underreported taxable gross receipts, or that the full amount of TAXPAYER's bank deposits constituted the better estimate of its taxable gross receipts, the burden shifted back to the Department to prove its case by competent evidence. *See, e.g., Novicki v. Department of Finance*, 373 Ill. 342, 345-46 (1940). The Department introduced no competent evidence to support either contention.

The next issue is whether TAXPAYER should be allowed a deduction for the amounts of food stamps for the last seven months of the audit period. The Department disallowed the deduction because those amounts were not confirmed by the USDA in a letter taxpayer obtained and turned over to the auditor for inspection. Department Group

Ex. No. 2, p. 7; Tr. p. 66 (Johnson). That letter identified only the period from January 1992 to May 1995. Department Group Ex. No. 2, p. 7. I conclude TAXPAYER rebutted the *prima facie* correctness of the Department's decision to disallow this deduction.

TAXPAYER's bank statements detailed the amounts of food stamps that TAXPAYER received in its business and deposited into its bank account during each of the 48 months in the audit period. *See* Department Group Ex. No. 2, pp. 12-13. The auditor recorded on a schedule each of the monthly deposits of food stamps identified in those bank statements. *Id.* The USDA confirmation letter and the Department's own schedule show identical entries regarding TAXPAYER's receipt and deposits of food stamps for the first 41 months of the audit period. *Compare* Department Group Ex. No. 2, p. 7 *with* pp. 12-13 thereof. I find no reason to believe that during the last seven months of the audit period, the employees of National Bank forgot how to accurately count how many food stamps TAXPAYER deposited into its account. The deductions claimed by TAXPAYER, therefore, were corroborated by books and records, and the information contained in those records was introduced as evidence at hearing. Department Group Ex. No. 2, pp. 12-13. Although the Department determined that TAXPAYER's bank records should be given no credence unless they were confirmed in writing by an employee of the Department of Agriculture (*see* Tr. p. 66 (Johnson)), I believe it was unreasonable to ignore that documentation.

The last issue is whether the Department properly disallowed the deductions TAXPAYER claimed for the amounts of tax it reported that it charged and collected from customers when making sales at retail. This issue must be resolved in favor of the Department.

Section 7 of the ROTA provides, in part:

To support deductions . . . authorized under this Act, . . . on account of receipts from any other kind of transaction that is not taxable under this Act, entries in any books, records or other pertinent papers or documents of



the taxpayer in relation thereto shall be in detail sufficient to show . . . the character of every such transaction, the date of every such transaction, the amount of receipts realized from every such transaction, and such other information as may be necessary to establish the nontaxable character of such transaction under this Act. \* \* \*

It shall be presumed that all sales of tangible personal property are subject to tax under this Act until the contrary is established, and the burden of proving that a transaction is not taxable hereunder shall be on upon the person who would be required to remit the tax to the Department if such transaction is taxable.

35 ILCS 120/7.

Section 405 of the Department's regulations provides, in part:

(a) "Gross receipts", on the basis of which Retailers' Occupation Tax liability must be computed, do not include charges which are added to prices on account of the seller's Illinois Retailers' Occupation Tax liability, or on account of the seller's liability for local Retailers' Occupation Taxes administered by the Department, or on account of the seller's duty to collect the tax imposed by the Use Tax Act.

\* \* \*

(g) If the seller, in collecting such tax or its equivalent, does not state it to the purchaser as a separate item from the selling price in accordance with procedures described in Section 150.1305 of the Use Tax Regulations (86 Ill. Adm. Code 150.1305), the failure to state the tax separately will create a rebuttable presumption that the tax was not collected. The seller will not be entitled to any deduction from total receipts because of having collected tax or its equivalent from the purchaser unless the seller can produce documentary evidence which shows that the tax or its equivalent was in fact collected.

86 Ill. Admin. Code §§ 130.405(a), (g) (How to Avoid Paying Tax on State or Local Tax Passed on to the Purchaser) (1991).

Taxpayer's president admitted that TAXPAYER did not keep cash register tapes from which it could document that it charged and collected tax as an item separate from the selling price of the tangible personal property transferred at retail. Tr. p. 111

(WITNESS). Taxpayer, moreover, offered no evidence whatever that it charged or collected tax regarding its sales at retail. Therefore, TAXPAYER has not rebutted the *prima facie* correctness of the Department's decision to disallow the deductions claimed regarding this issue.

**Conclusion:**

Taxpayer rebutted the Department's determinations that TAXPAYER underreported its taxable gross receipts on the returns it filed with the Department, or that TAXPAYER's bank deposits more accurately reflected the amount of its taxable gross receipts. Taxpayer also rebutted the Department's determination to disallow the deduction Green was due for the amounts of gross receipts it received in the form of food stamps during the last seven months of the audit period. TAXPAYER did not rebut the *prima facie* correctness of the Department's determination to disallow the deductions TAXPAYER reported as tax claimed to have been charged and collected regarding its retail sales. I recommend the Director revise the Notices of Tax Liability issued against TAXPAYER consistent with the findings and conclusions set forth in this recommendation, and that those assessments be finalized as revised.

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Date

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Administrative Law Judge